


To: Moulton, G, Evanchik, A E., Wolfe, Laney, Mallardi, J, Groll, A P., Perez, F J., Maney, F, Richards, M,
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Posted: 9/4/97 12:27
Opened: 9/4/97 12:27
Subject: CTS Information



Attached is additional CTS information which you might find useful when discussing this Segment with Customers.

CC: 1200 - New York Region (SCULLYA), 1300 - Philadelphia Region (SWEETD)



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Tobacco Company

RJ Reynolds

*CIGARETTE TOBACCO
STORES*

THE CIGARETTE / TOBACCO STORE

The CTS Trend

- From 1996 thru mid '97 over 2000 new CTS locations opened in the U.S.
- With less than 2% of the retail store universe, this trade channel represents 12% of all cigarettes sold.
- The CTS makeup is still dominated by independents and small chains (two major players).
- Strong interest from the major chains to enter the category.
- Legislative climate has been the driving force behind expansion.

Who are the CTS shoppers?

- Older more like SM, DG, MM consumers
- Biggest segment of CTS shoppers are the 35+ age groups
- Value oriented...FP (56%) BS (39%)
- Skewed toward carton purchases
 - 80-85% by the carton
- Packs will play a bigger role as CTS outlets become more convenient

25-34	8%	4%	4%
35-44	35%	39%	23%
45-54	35%	34%	35%
55+	25%	43%	39%

Proposed Tobacco Settlement Topline

- Agreement at this point is just an outline. Remaining steps include Congress and Presidential agreement. It is impossible to predict the final outcome or the timing of this process.
- Non Age restricted retail outlets will face the most restrictions as it relates to product access and advertising. Product must be placed out of reach of consumers and all transactions must be clerk assisted. Manufacturer display activity is relegated to back counter positions.
- POS advertising in non-age restricted outlets will be limited in both size and number of pieces allowed. All POS will be black letters on white background. All color tobacco advertising will be eliminated in accordance to the time frame parameters of the agreement.

Proposed Tobacco Settlement Topline

- Age Restricted Outlets will be allowed to continue to merchandise product in a self-service manner as they are today.
- The continued usage of color advertising is allowable in age restricted outlets provided it can not be seen from the outside of the store.
- Implementation timing following Congressional / Presidential approval is as follows:
 - Display Compliance (NSS) - 9 months
 - Retail Signage Compliance - 5 months

LEGISLATION IMPACT ON RETAIL ?

- Today, cigarettes are part of the retail mix in over 350,000 retail outlets throughout the U.S.
- Retailers will be faced with a decision regarding the future role of the tobacco category for their stores.
 - ! Traditional retailers are reacting to the Proposed Tobacco Settlement with varying levels of concern
 - ! The proactive - protect the category with whatever it takes
 - ! The apathetic - let the category seek its own level.
- In recent years many chains within the Supermarket, Mass Merch. and Drug Trade channels have de-emphasized the category
 - ! Contribution to total store profits is much less significant then it once was. For some, discontinuing sales is a possibility if legislative mandates require special effort.

CTS OF THE FUTURE

■ We believe the competitive / successful CTS should:

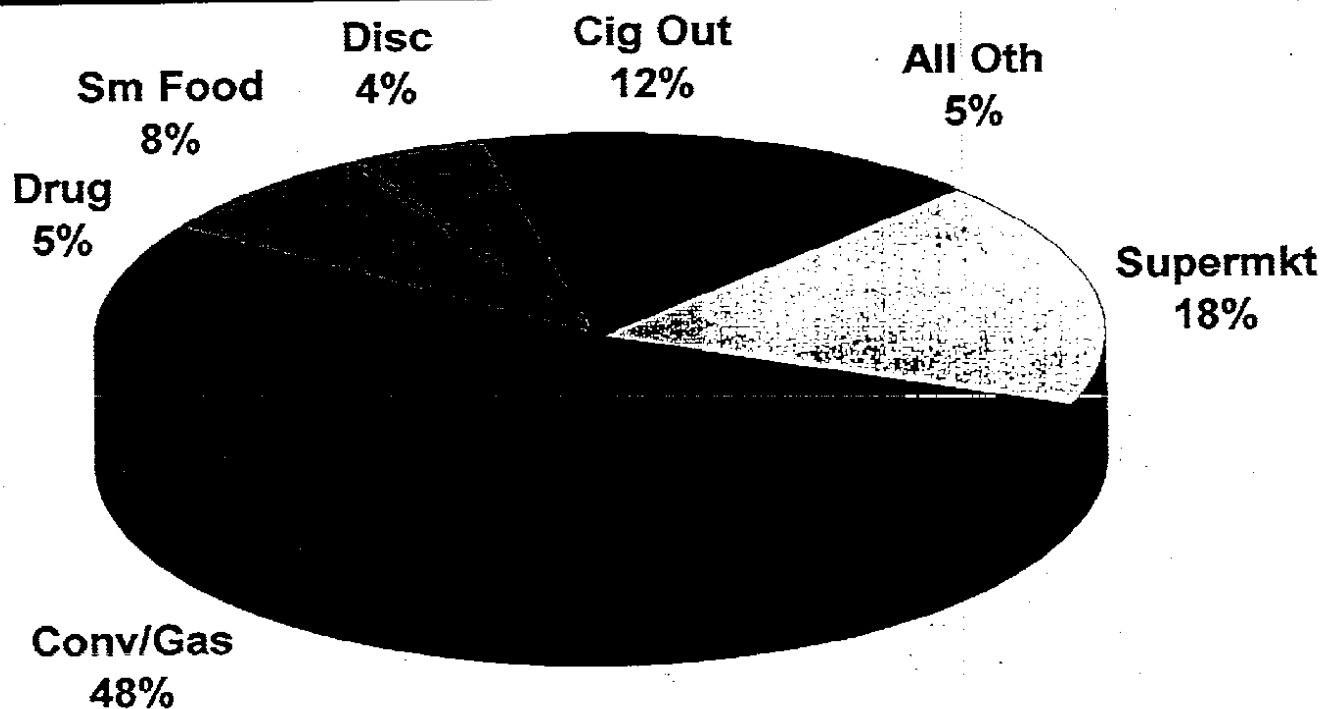
- ! Select locations that can attract both carton and pack shoppers
- ! Drive pack promotion and trial
- ! Offer early A.M. services (coffee, newspaper, donuts)
- ! Consider Gas pump locations
- ! Take "Consumer Friendly" to the next level
 - ! Smokers Lounge
 - ! Expanded Cigar Selection - Walk-In Humidor
 - ! Delivery service
- ! Expanded "Adult" categories - Beer, Lottery, Adult Publications
- ! Offer programs others don't - NASCAR, Continuity Redemption

LEGISLATION IMPACT ON RETAIL ?

Retail Response Options:

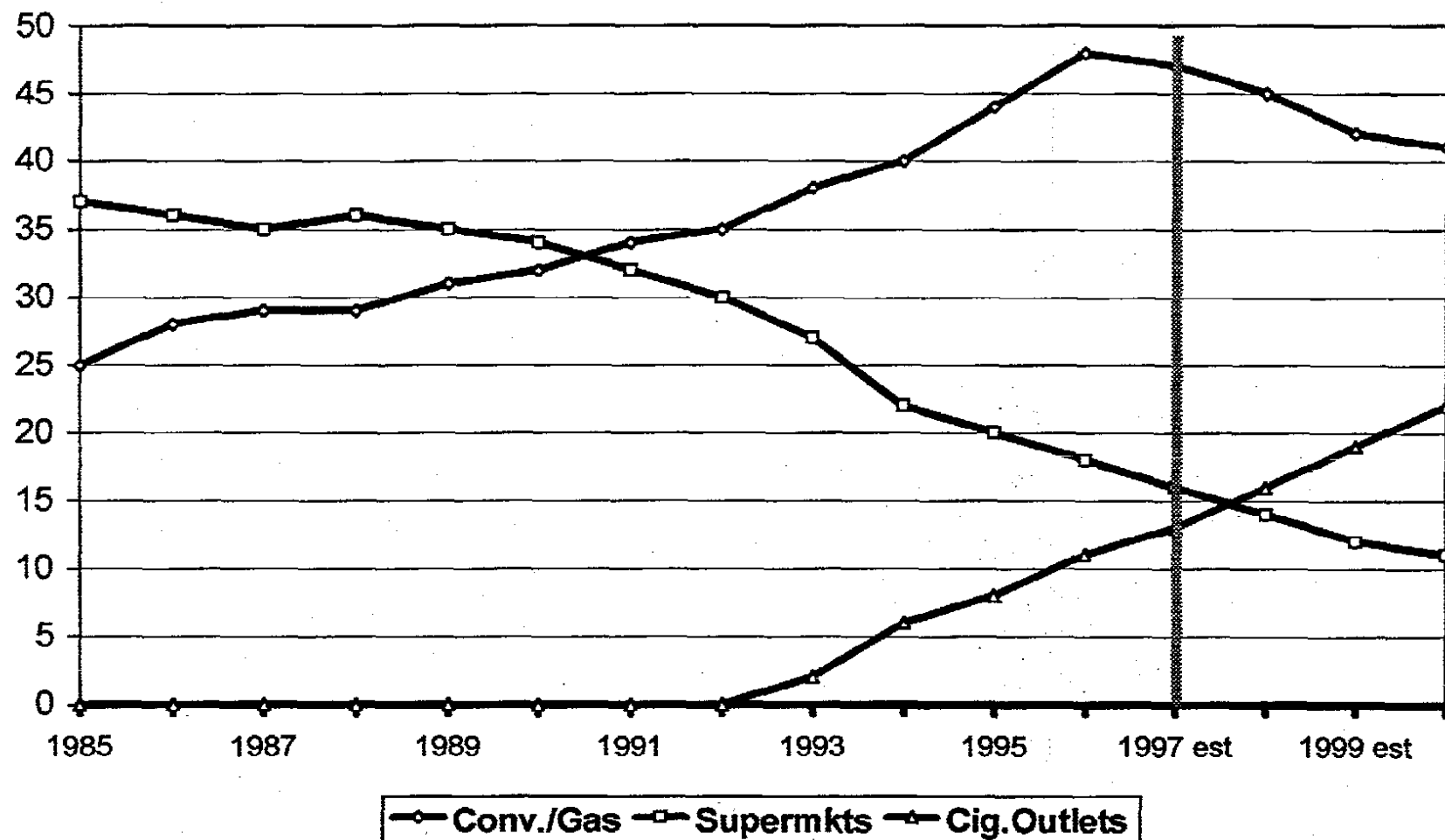
- Proactive retailers, regardless of trade channels will be forced to deal with legislative issues and at the same time respond to the emergence of CTS growth by considering the following options:
- Departmentalization - in many cases this will mean implementing a backbar (nss) configuration to feature packs and cartons as well as promotion
- Store-in-a-store concept can provide a mini-CTS in a controlled and age restricted environment within the current retail structure.
- Open CTS locations.

“Where Consumers Purchase.....Today”



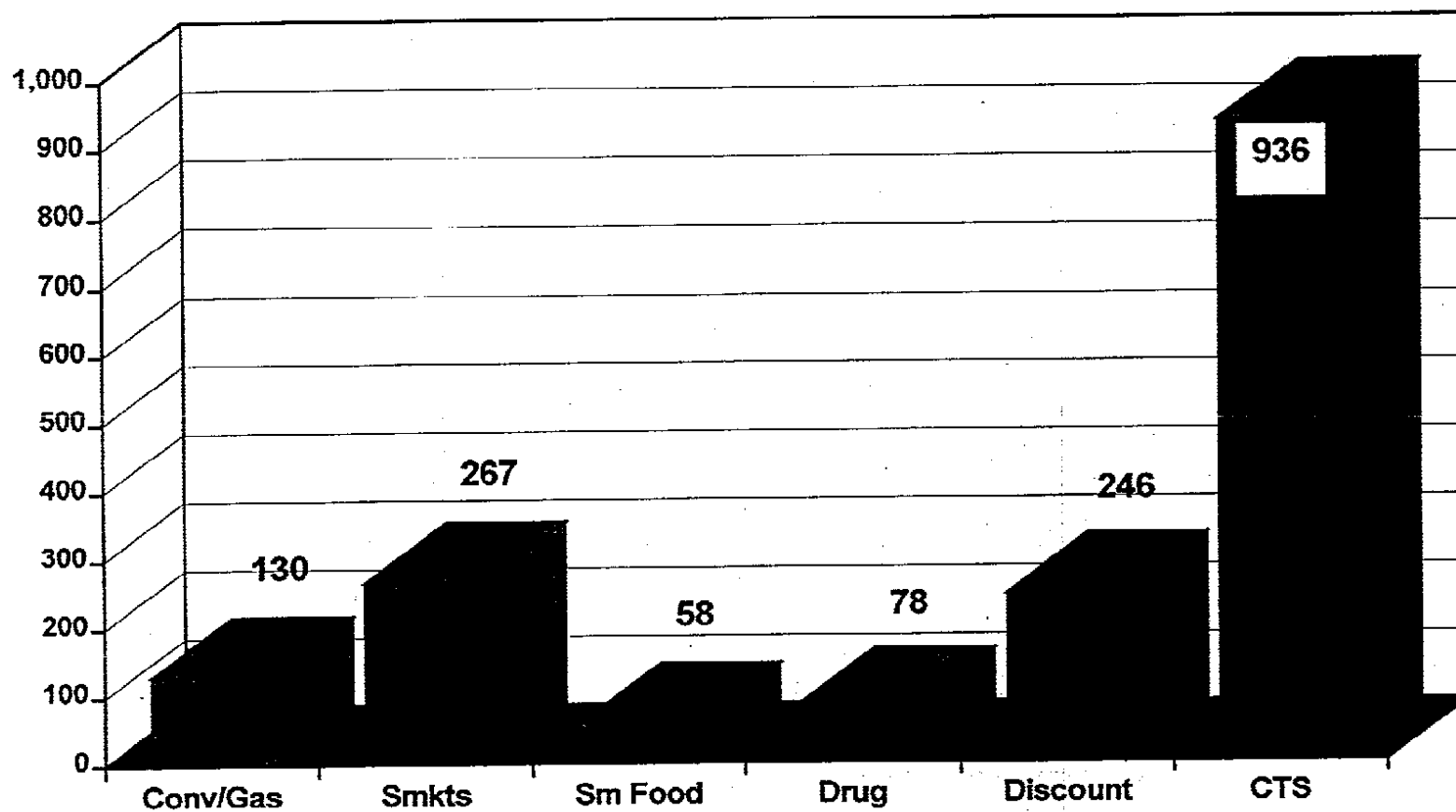
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Total U.S. Share of Cigarette Industry Volume Major Trade Class Trends



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Total U.S. -
Average Weekly Per Store Volume By Trade Class



Introduction

- The Mega Volume Cigarette Outlet isn't a new concept
 - ! Indian Reservation Stores and Cigarette Stores along tax advantaged state borders have existed for many years.
 - ! Aside from the natural price advantages of these outlets, manufacturers poured-in additional promotional resources to make the retail pricing even more attractive
 - ! Volumes in these outlets ranged as high as 25,000 CPW
- Recently the CO has gone mainstream
 - ! Strip Center locations and free standing stores within business districts have recently become frequent sites for Cigarette Tobacco Stores
 - ! Unlike the "fire sale" image of the Indian and Boarder CO, these stores are a cleaner, upscale version offering tobacco products at lower prices than neighboring retailers
 - ! The longer term inspiration for the CTS growth boom is legislation working in favor of this concept and against the traditional retail venues

THE CIGARETTE / TOBACCO STORE

- CTS offer consumers an opportunity to buy their cigarettes in a clean, smoker-friendly atmosphere.
- Today's CTS offer their shoppers the brands they want at competitive retail prices and a variety of manufacturer sponsored promotional programs.
- Manufacturers can make available complete fixturing and display components to meet the needs of the retailer along with a variety of upscale signage elements that tastefully communicate brand messages and promotion announcements.
- Most CTS offer few categories beyond tobacco products and related accessories. Limited testing of a cigarette, beer and gas concept is in place.

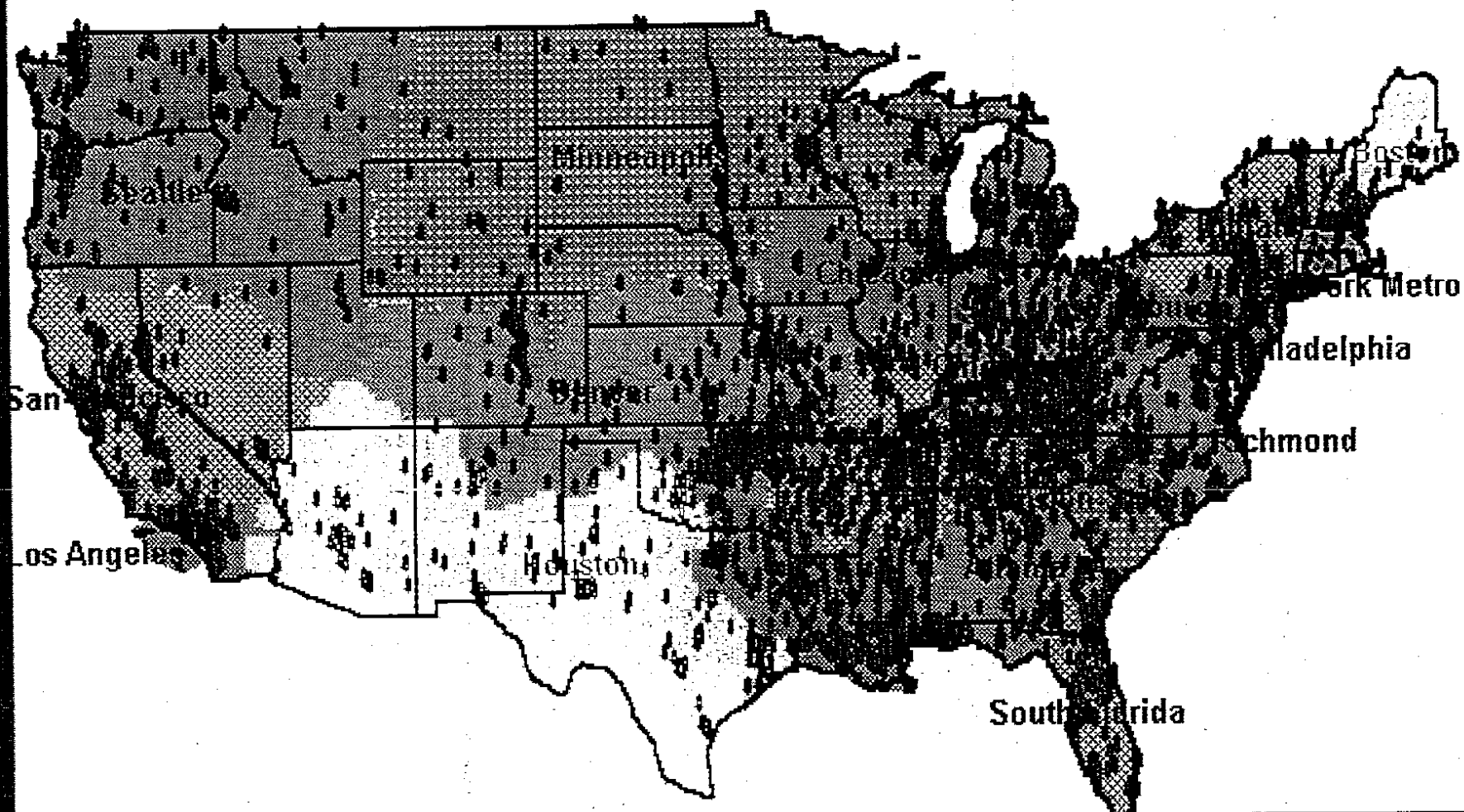
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THE CIGARETTE / TOBACCO STORE

The Trend

- Over 2000 new Cigarette Tobacco Stores opened from '96 thru mid '97.
- With less than 2% of the outlets, the CTS retails 12% of all cigarettes sold.
- Today the trade channel remains Independent and small chain dominated (1 major player) . C-store chains are entering the CTS concept. Store-in-a--store formats are also being tested.
- 1998 could be the year that the major chain players enter the category in a big way when legislation impact gets clearer.

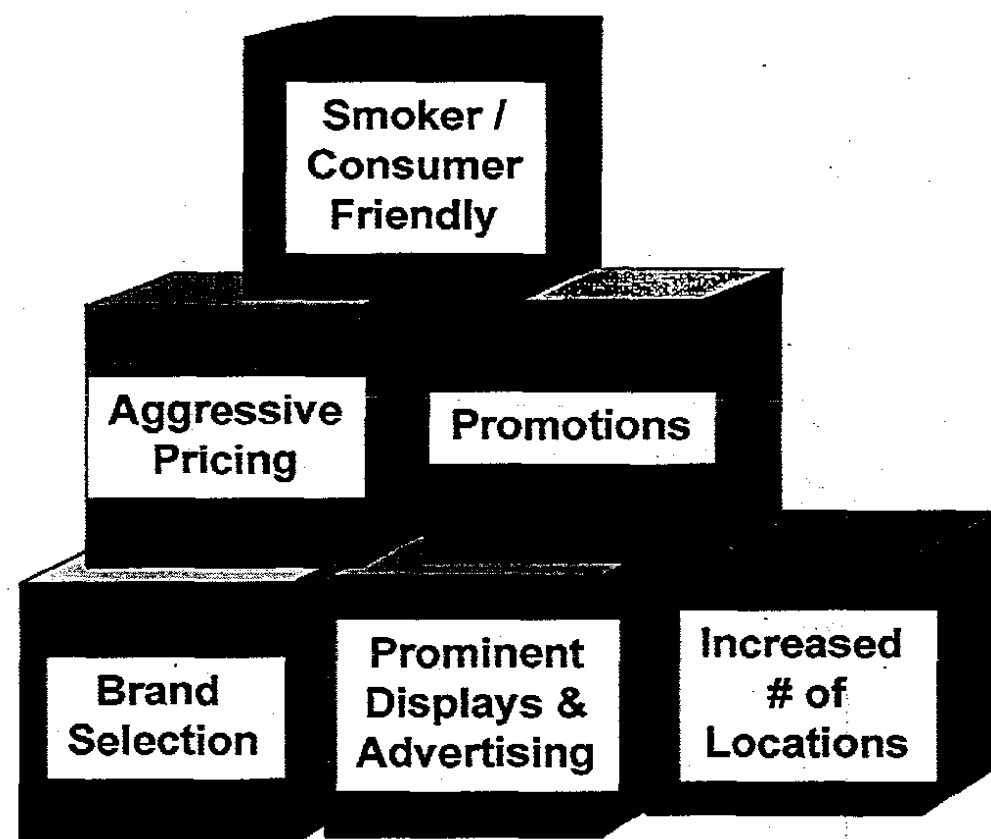
Cigarette / Tobacco Stores



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CTS Performance

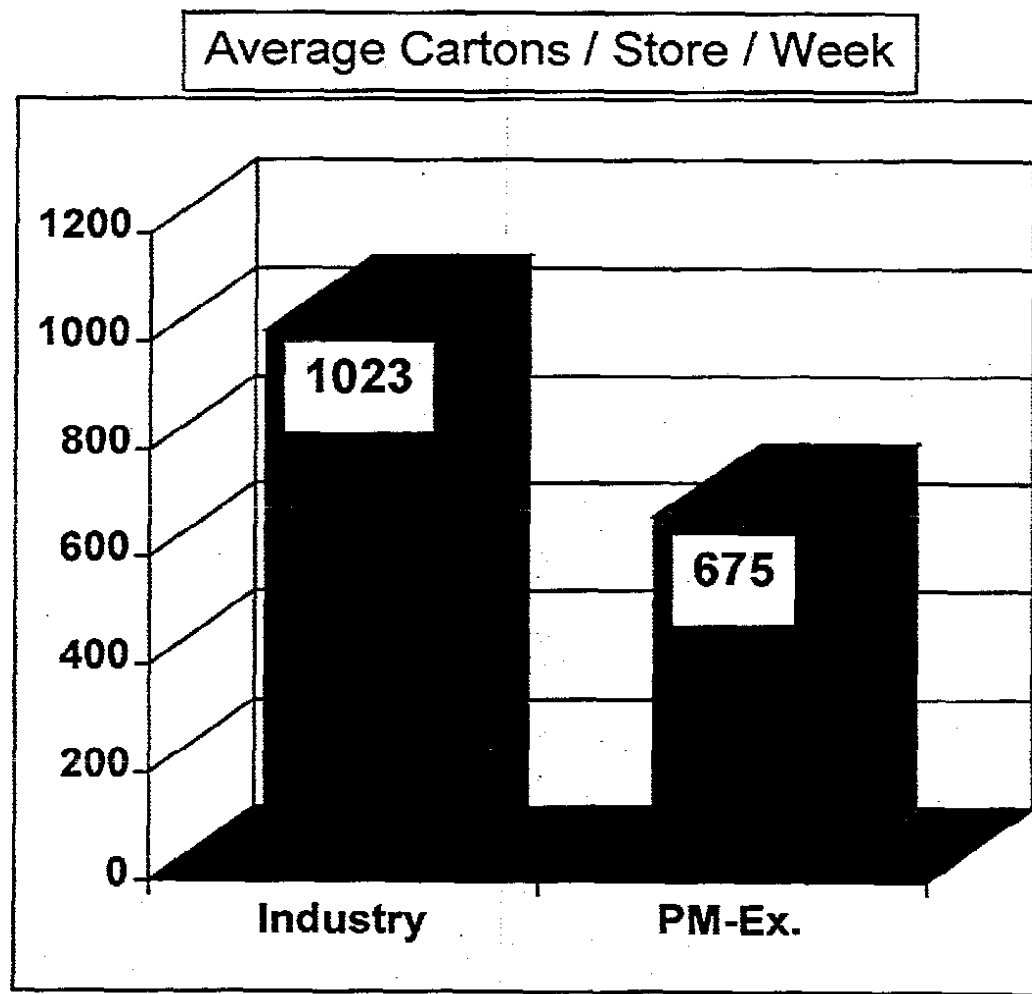
"What makes this format successful?"



THE CIGARETTE / TOBACCO STORE

- If Cigarette / Tobacco Stores Are The Future Growth Outlets
- How Do They Compare In Today's Environment ?

**INDUSTRY APPROACH
Versus
PM - EXCLUSIVITY**



THE CIGARETTE / TOBACCO STORE

Three Types of Outlets:

	<u># Stores</u>	<u>CPW</u>
• Reservation Store	504	2,340
• Boarder / Interstate	220	1,667
• Cigarette / Tobacco Store	4,900	926

THE CIGARETTE / TOBACCO STORE

Retail Display Allowances :

- Cigarette / Tobacco Store retail merchandising contract requirements vary by company, however they generally target the following components:
 - Equitable inventory and space for packs and cartons
 - Product availability / Brand selection
 - Promotional display capability for packs and cartons
 - Signage to communicate brand messages and promotion activity
- Although RDA payments are important, overall profitability and ultimate success must come from the category's sales performance.
- A **Total Category Management** approach ensuring exposure and promotional resources across all brands and price tiers is recommended to build business and maximize customer satisfaction.

CTS Profitability Snapshot (from cigarette sales only) :

	Average Weekly Volume		
	<u>800 CPW</u>	<u>1000 CPW</u>	<u>1200 CPW</u>
Total Dollar Sales	\$667,434	\$834,292	\$1,001,151
Pack / Carton Ratio	20/80	20/80	20/80
Gross Margin - Carton	7.4%	7.4%	7.4%
Gross Margin - Pack	15.5%	15.5%	15.5%
Total Weighted G.M.%	9.1%	9.1%	9.1%
Gross Profit	\$61,031	\$76,288	\$91,546
Industry Display Allow. (Annual)	\$19,308	\$22,068	\$22,668
Total Gross Profit	\$80,339	\$98,356	\$114,214
Average Inventory Cost	\$23,623	\$29,154	\$34,985
Average Turns Per Year	26	26	26
ROI \$	\$2.62	\$2.62	\$2.62
Pre-Tax Expenses (Est.)	\$60-75K	\$60-75K	\$60-75K
Cost Input: Full Price \$15.89 (56 SOM) Savings \$13.19 (39 SOM) Private Label \$10.69 (5 SOM) Fair Trade States may require higher margins then what is used in this non fair trade state example			

* Cost data includes Federal Tax (\$2.40 per carton) and average State tax (\$3.50 per carton).

* Pre Tax Expenses will vary depending on salaries , lease costs, level of advertising etc.